Industry Briefing
Rating Insights

June 2012

Microfinance Industry Report Card: good performance of Cambodian MFIs still driven by portfolio growth

In the period January 2011 – April 2012, MicroFinanza Rating rated 6[1] Cambodian MFIs, accounting for 50% of the total outstanding portfolio and 60% of total borrowers as of December 2011 (CMA Network Information Exchange).

Industry Ratings Outlook

Overall, during 2011 the rated microfinance institutions showed good portfolio quality indicators, good profitability indicators and adequate capitalization levels.

Assets growth (45% y-o-y in 2011) and portfolio quality (PAR 30 0.4% as of December 2011) represented the main driver for the consolidation of net income and profitability (ROA stands at 4.3% and equity to assets ratio at 21%[2]). Despite the positive indicators, we maintain our ratings' outlook stable. Cambodia's economy is expected to continue to heavily depend on garment manufacturing, making it especially vulnerable to any global slowdown. Likewise, despite a positive growth in terms of saving deposits, microfinance institutions still strongly depend on funding from specialized microfinance investors, which have reached an important exposure on the country (about USD 400 M as of December 2011).

Strong portfolio quality

After the drop registered in 2009, rated microfinance institutions have recovered and achieved strong portfolio quality.
Some of the institutions need to consolidate the loan loss reserve which, although adequate to cover the PAR30 and compliant with the NBC requirements, stands at low levels over the outstanding portfolio. A forward looking assessment of the credit risk need to consider the increasing average loan size, an average expected portfolio growth of 30% and the business concentration of the Cambodian economy.

Besides, the expansion in the SME market of some microfinance institutions requires a consolidation of the analysis of the clients' repayment capacity also considering that the enforcement of collaterals presents some shortcomings.

The issue of cross-indebtedness is a common concern among rated MFIs. The launch of the Credit Bureau in April 2012 represents a step forward to the understanding of the clients' debt exposure. In the next months, we expect institutions to define more precise cross-indebtedness policies. It is worth mentioning that while it is a common practice to consider the household cash flow in the analysis of the repayment capacity of the client, the Credit Bureau access fee might not create incentives to gather information on the whole household.

Capitalization remains adequate and savings mobilization is increasing

Capitalization of the rated institutions stands at adequate levels. Micro-deposit taking institutions have higher leverage than before, which is however still in compliance with the local requirements.

MF Rating HQ
Via Rigola, 7
20159 Milan – **Italy**
Tel: +39-02-3656.5019

www.microfinanzarating.com
info@microfinanzarating.com

[1] KREDIT has been rated in May 2012 and VF Cambodia will be rated in July 2012.

In general, deposit mobilization does not show impact on the net interest margin as in this initial phase the institutions tend to focus on term deposits bearing a relatively high cost. Savings granularity in general is adequate with no particular concentration levels. Particular attention should be paid to the analysis of the volatility along with the increasing volume of saving deposits. For micro-deposit taking institutions overall representing more than 80% of the total portfolio, saving mobilization represents not only a potential important source of funds but also an opportunity towards diversification of services.

Operations remain overall efficient, while product diversification can be improved

The rated microfinance institutions show overall adequate level of efficiency given the adopted business model. Operation risk management is adequate considering the volume of transactions and the implementation by most institutions of upgraded MIS.

Risk management framework remains an area for improvement, especially in terms of strategic and scenario analysis. On the other hand, institutions are generally supported by experienced BoD providing adequate supervision and guidance.

It is worth mentioning that microfinance institutions in Cambodia *de fact* represent the financial sector outside Phnom Penh, with only the ACLEDA BANK operating nationwide. Product diversification need to be improved to support the expected returns without exclusively focusing on lending as well as to enhance financial inclusion.

Social performance management and client protection

With the exception of AMK and Chamroeun, which maintain a strong focus on poverty outreach, the other rated MFIs have shown an evolution in terms of target clientele with an increasing focus on more profitable market segments, including the SME sector. Such evolution has questioned the alignment of some institutions' strategies with their missions as well as their capacity to monitor the achievement of social goals to inform the decision making process.

Client protection is overall adequate thanks to appropriate product design despite the limited diversification, good transparency, fair pricing of services, and privacy of clients data. On the other hand, the risk of clients' overindebtedness remains high. The effectiveness of the Credit Bureau needs to be proved in the medium term, especially considering the high fees – which might for example discourage MFIs from investigating the credit history of other household members – and the poor formalization of cross-indebtedness policies. Policies ensuring a fair treatment of clients need also improvement, especially to avoid excessive pressure in the recovery process.

Microfinance Rating (validity 12 months)	Date	Status
HKL (A-/Stable) HKL shows good and increasing performance results after having experienced a drop in 2009 due to the global economic turmoil. In 2010 the institution has demonstrated a sound pattern of portfolio growth coupled with an improved portfolio quality, even though some portfolio concentration is still present. Overall performance has however slightly declined if compared to the results achieved in 2007-2008. In order to ensure the expected growth for 2011 and 2012, the institution needs to boost the capital to maintain the CAR above the regulatory requirements. Within this perspective, HKL has already put in place a strategy through fresh capital injection and contracted subordinated debts. The institution relies on good ownership structure and on qualified BoD with a sound experience in microfinance. Top management team is skilled, while the organizational structure and HR management represent crucial areas that need to be strengthened to support the planned expansion, the product	**05/2011**	**Expired**

development and the saving mobilization plans. Financial risk management is also an area for improvement considering the increasing sophistication of the funding structure and the ALM. The risk of client over-indebtedness, partly due to a high competition, remains relevant in the whole sector and is exacerbated by the lack of a Credit Bureau.

AMK (A/Stable) Report not available for public distribution	**07/2011**	**Current**
Chamroeun (B+/Stable) Chamroeun is a young institution, which achieved its sustainability for the first time in 2010. Profitability levels need therefore to be confirmed in the short-medium term. The institution is constantly expanding its operations and portfolio and requires additional capital to sustain its planned growth. Advanced negotiations are on-going with specialized investors, which will soon strengthen the ownership structure of Chamroeun. Considering the target clientele, financial and operational results are strongly linked with productivity and portfolio quality levels. The latter have been always good, even though the practice of off-setting late loans with compulsory savings need to be tracked in order to adequately monitor the borrowers' credit risk, also considering the quite high risk of over-indebtedness in the country. Operations need to be strengthened at field level through better segregation of functions and dual controls in order to improve internal control as well as efficiency. Financial, leadership and coaching expertise needs to be improved at senior management level to make the decision making process more effective. Liquidity and currency risk management (the latter negatively affecting Chamroeun's results) are not fully integrated in consolidated tools, thus hampering a comprehensive analysis. The whole decision making process might also be affected by a governing body that is not adequate in terms of size and expertise.	**07/2011**	**Current**
MAXIMA (B+/Stable) Maxima shows positive and good performance results, slightly decreasing from the previous year due to a downward pressure on the portfolio yield. Productivity and efficiency are below the local market benchmark, whereas provisioning costs are at their minimum thanks to very good portfolio quality. Although the equity to asset ratio is medium-high as at Sep-11, Maxima's solvency is adequate considering the capital injection approved by the shareholders and under final approval by the Central Bank. The governance shows some gaps in terms of formalized policies and weak separation from management, partly justified by the ownership structure. Internal control systems are an area for improvement considering the still high number of cash transactions. Although formalization of policies is acceptable, procedures and audit need to be better structured. The institution is mainly exposed to a business risk, linked with high competition in its market niche and a slowly growing clients' base. The business risk is an area to be prioritized within a strategic and risk management framework.	**01/2012**	**Current**
AMRET (A-/Stable) AMRET is very well performing in terms of profitability all over the periods under analysis. The decreasing trend of the portfolio yield, registered in the last two years, has been offset by a contemporary reduction of the funding expense ratio, while efficiency has been kept at adequate levels. Portfolio quality is very good, but loan restructuring policies and formalization show some room for improvement. Considering the highly competitive market, the institution is not fully covering the credit risk. Capital adequacy is good and	**04/2012**	**Current**

capitalization strategy is aligned with medium term objectives of transformation into a commercial bank. Corporate governance is well structured, with a strong Board of Directors whose composition reflects the solid and diversified ownership structure. Top management is at good levels providing for effective decision making. Strategic vision and planning capacities are adequate, even though operational planning and financial modelling are not fully satisfactory. Key areas to be addressed are MIS/IT and financial risk management. Increasing market competition by commercial banks and MFIs and the current lack of a credit bureau are context-related challenges.		
SATHAPANA (BBB+/Stable) Sathapana shows sound profitability levels over the period of analysis. Reported portfolio quality is very good and the institution has managed to maintain acceptable levels even during the global economic downturn. Although capitalization is adequate, the capital cushion can be improved. The institutional growth relies on the capacity of the institution to timely negotiate subordinated debts. Sathapana's liquidity position is adequate and the funding structure diversified. The increase in savings mobilization would require a more sophisticated analysis on their volatility in order to define cash cushion tailored to customer behavioural analysis. Sathapana leverages on a reputable shareholder structure; governance and top management adequately supervise and guide the whole operations. Risk management remains an area for improvement. The current portfolio growth and the gradual increase in the SME portfolio would call for a strengthening of HR at middle management, an upgrade of the reporting system (which is actually already on-going) and a consolidation of the internal audit functions and internal control systems (policies and procedures among others). The quite high competitive environment and the significant market penetration in some areas expose the sector to multiple borrowings which can be better monitored through the imminent launch of the Credit Bureau.	**05/2012**	**Current**

For further information contact: Marco Boa at marco.boa@microfinanzarating.com
For the full ratings reports contact: Paola Demaria at paola.demaria@microfinanzarating.com